Supreme Court, U.S.
FILED
JAN 14 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-985

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FINA OIL AND CHEMICAL COMPANY, *et al*,

Petitioners,

v.

EL PASO NATURAL GAS COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS FOR THE
FIRST SUPREME JUDICIAL DISTRICT OF TEXAS

RESPONDENT'S BRIEF IN OPPOSITION

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TABLE OF CONTENTS

	PAGE
RULE 28.1 LISTING	ii
TABLE OF AUTHORITIES	iv
I. JURISDICTION	1
II. STATUTE INVOLVED	2
III. STATEMENT OF FACTS	2
IV. REASONS WHY PETITION SHOULD BE DENIED	4
1. The decision of the Texas Court of Appeals does not raise the Question Presented in the Petition	4
2. The Supreme Court does not have jurisdiction to review the decision of the Texas Court of Appeals	6
3. The sole Question Presented in the petition is one of fact, which the Texas Court of Appeals found unnecessary to decide	7
4. This Court will not review a state court judgment on an academic or episodic question of law	8
V. CONCLUSION	9
CERTIFICATE OF SERVICE	10

RULE 28.1 LISTING

The following is a list of all parent companies, subsidiaries and affiliates (except wholly-owned subsidiaries) of El Paso Natural Gas Company:

Burlington Northern Inc.
- BN Financial Services Inc.
- BN Geothermal Inc.
- BN Leasing Inc.
- Burlington Northern Foundation
- Burlington Northern International Services Inc.
- Burlington Northern Motor Carriers Inc.
- Burlington Northern Overseas Finance Company N.V.
- Burlington Northern Railroad Company
  - The Belt Railway Company of Chicago
  - Camas Prairie Railroad Company
  - Davenport, Rock Island and North Western Railway Company
  - The Denver Union Terminal Railway Company
  - Houston Belt & Terminal Railway Company
  - Iowa Transfer Railway Company
  - Kansas City Terminal Railway Company
  - Keokuk Union Depot Company
  - The Lake Superior Terminal and Transfer Railway Company
  - Longview Switching Company
  - M T Properties, Inc.
  - Paducah & Illinois Railroad Company
  - Portland Terminal Railroad Company
  - Terminal Railroad Association of St. Louis
  - Trailer Train Company
  - The Wichita Union Terminal Railway Company
- CBR Distribution Corporation
- Colt Intermodal Inc.
- Glacier Park Company
- Glacier Park Liquidating Company
- Meridian Minerals Company

M-R Holdings Inc.
National Exchange, Inc.
New Mexico and Arizona Land Company
Plum Creek Timber Company, Inc.
Research Applications Inc.
The El Paso Company
  Meridian Oil Holding Inc.
    Meridian Oil Inc.
      Butte Pipe Line Company
      Portal Pipe Line Company

TABLE OF AUTHORITIES

Cases

	PAGE
El Paso Natural Gas Co. v. *American Petrofina Co. of Texas,* 733 S.W.2d 541 (Tex.App.-Houston [1st Dist.] 1986, writ ref'd n.r.e.)	1
El Paso Natural Gas Co. v. *Sun Oil Co.,* 708 F.2d 1011 (5th Cir. 1983), *cert. denied,* 468 U.S. 1219 (1984)	2
Exxon Corp. v. *Eagerton,* 462 U.S. 176 (1983)	7
Herb. v. *Pitcairn,* 324 U.S. 117 (1945)	7
Layne and Bowler Corp. v. *Western Well Works,* 261 U.S. 387 (1923)	8
Public Service Comm'n of New York v. *Mid-Louisiana Gas Co.,* 463 U.S. 319 (1983)	3, 4, 5
Rice v. *Sioux City Cemetery,* 349 U.S. 70 (1955)	8

Administrative Cases

El Paso Natural Gas Co., 20 F.E.R.C. (CCH) ¶ 61,443 (1982)	6
El Paso Natural Gas Co., 26 F.E.R.C. (CCH) ¶ 61,365 (1983)	3
Kentucky-West Virginia Gas Co., 21 F.E.R.C. (CCH) ¶ 61,257 (1982)	6
Order No. 391-B, "First Sales of Pipeline Production Under Section 2(21) of the Natural Gas Policy Act of 1978,", 40 F.E.R.C. (CCH) ¶ 61,174 (1987), reh'g granted, 52 Fed. Reg. 37,928 (Oct. 13, 1987)	7

Statutes and Regulations

18 C.F.R § 154.38(d)(4)	3
15 U.S.C. § 717-717u (Natural Gas Act of 1938)	3
15 U.S.C. § 3301 *et seq.* (Natural Gas Policy Act of 1978)	2, 6
28 U.S.C. § 1257 (1982)	2, 6

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RESPONDENT'S BRIEF IN OPPOSITION

The Respondent, El Paso Natural Gas Company (hereinafter "Respondent"), respectfully requests that this Court deny the petition for writ of certiorari, seeking review of the Court of Appeals for the First Supreme Judicial District of Texas' ("Texas Court of Appeals") judgment in this case. The opinion of the Texas Court of Appeals is reported at 733 S.W.2d 541 (Tex. App.-Houston [1st Dist.] 1986, writ ref'd n.r.e.).

I.
JURISDICTION

As demonstrated in the opinion of the Texas Court of Appeals, the judgment was based solely on state law grounds. The dispositive issue in the Texas Court of Appeals was whether Respondent was entitled to reconvey natural

gas wells and acreage to Petitioners[1] in accordance with the express terms of gas lease-sales agreements between the parties. The court, without deciding any questions of federal law, simply construed the gas lease-sales agreements according to principles of contract interpretation and state oil and gas law. This Court, therefore, lacks jurisdiction under 28 U.S.C. § 1257 (1982) to grant Petitioners' application, or to review the decision of the Texas Court of Appeals.

II.
STATUTE INVOLVED

The judgment of the Texas Court of Appeals did not draw into question any federal statute. The court's discussion of § 104 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3314 (1982), assumed the validity of that Act, and was included in the court's opinion for the purpose of explaining the procedural and factual history of the case. The court's holding, that Respondent had no duty to keep the gas wells in question profitable, did not involve the interpretation of any federal statute.

III.
STATEMENT OF FACTS

The relevant facts are fully set forth in the opinion of the Texas Court of Appeals and in the opinion of the Fifth Circuit Court of Appeals in *El Paso Natural Gas Co.* v. *Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983), *cert. denied*, 468 U.S. 1219 (1984). The facts are set out briefly here for the Court's convenience.

Respondent and Petitioners are parties to agreements commonly denominated as gas lease-sales agreements ("GLAs") which were executed in the 1950s. Under these

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[1] Petitioners correctly state the parties to this proceeding with the exception that Respondent and Sun Exploration and Production Company ("Sun") have agreed to settle all matters at issue with regard to Sun's gas lease-sale agreement.

agreements, Respondent acquired gas leasehold rights for properties located in the San Juan Basin of New Mexico. In exchange for the leases, Respondent agreed to pay cash for the wells located on the properties and agreed to pay for the gas and liquefiable hydrocarbons on the basis of an overriding royalty that was subject to escalation over a specified period of time and thereafter subject to redetermination based on the fair market value of the gas. The parties agreed to arbitration in the event they were unable to agree as to future overriding royalties.[2]

As a result of rate filings made by Respondent with the Federal Energy Regulatory Commission ("FERC"), effective October 1, 1983, the GLA Properties became unprofitable to Respondent.[3] It, therefore, exercised its right, granted under certain of those agreements, to reassign "unprofitable wells" and "non-commercial acreage". It also sought a declaratory judgment in this case confirming those rights. The state district court ruled against Respondent. The Texas Court of Appeals reversed and rendered that portion of the judgment relating to those GLA agreements that had an unprofitably clause and an undeveloped acreage clause. The Texas Supreme Court refused to grant a discretionary writ of error

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[2] The amount of Petitioners' royalty bore no relation to and was not dependent upon the amount which Respondent recovered through sale of the gas.

[3] Respondent, as an interstate pipeline subject to the Natural Gas Act, 15 U.S.C. § 717-717u (1982), is required to file its rates with the FERC. It may make periodic adjustments to those rates based on changes in purchased gas costs at specified intervals. *See* 18 C.F.R. § 154.38(d)(4). El Paso's purchase gas adjustment ("PGA") filing effective October 1, 1983 which implemented NGPA pricing for its pipeline production was the result of a settlement of a rate case to which Petitioners were parties. *See El Paso Natural Gas Co.* 26 F.E.R.C. (CCH) ¶61,365 (1983). Under that settlement El Paso agreed to implement NGPA pricing in its first PGA filing after this Court's decision in *Public Service Comm'n of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983). No appeal was taken from that rate case by Petitioners.

to review that decision with the notation "no reversible error." Petitioners' application to stay the mandate of the Texas Court of Appeals pending certiorari was denied by the Court on December 14, 1987.

IV.
REASONS WHY THE PETITION SHOULD BE DENIED

1. The decision of the Texas Court of Appeals does not raise the Question Presented in the petition.

The sole Question Presented in the petition is:

> Whether an interstate natural gas pipeline company can utilize an incorrect application of federal law governing natural gas, and a misconstruction of this Court's interpretation of such federal law in *Public Service Comm'n of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983), to destroy Petitioners' property interests in natural gas producing properties operated by the pipeline, which interests were recognized and preserved by a final holding of the United States Court of Appeals for the Fifth Circuit.

The Texas Court of Appeals did not construe or rely on any federal statute and its judgment did not "destroy" Petitioners' interest in the properties in question. The court's judgment allows Respondent to reassign the properties to Petitioners, making them the outright owners of fully developed, producing gas wells rather than overriding royalty interest owners.

The judgment of the Texas Court of Appeals was based solely on state law. The sole issue before the court was whether Respondent was entitled, under the terms of the GLAs, to reconvey certain wells and acreage to Petitioners. The GLAs contained clauses that allowed Respondent the option to reconvey wells and drilling units to Petitioners in the event they became unprofitable and required Respondent to reassign undeveloped acreage in the event that it would not be productive of gas in commercial quantities.

App. at 8a.[4] The Texas Court of Appeals made it clear that the construction and application of these controversial clauses "substantially control this case." App. at 10a.[5] The court held that, in determining whether a well had become unprofitable, or whether acreage would be productive in commercial quantities, Respondent was entitled to deduct, as a cost of production, the overriding royalties it was obligated to pay Petitioners under the terms of the GLAs. App. at 10a-14a. Because the amount of royalties exceeded the price Respondent recovered for the gas produced, the wells and acreage had become unprofitable and could, therefore, be reassigned to Petitioners under the operative clauses in the GLAs. App. at 6a, 28a.

Petitioners' contention that the court misinterpreted this Court's opinion in *Public Service Comm'n of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) ("*Mid-Louisiana*"), disregards the fact that the interpretation of that decision was not a factor in the court's judgment. Had the court interpreted *Mid-Louisiana* in a wholly contrary manner, or simply omitted any reference to the case, the judgment would remain unaffected.

Contrary to Petitioner's claim, the Texas Court of Appeals did not hold that Respondent properly abandoned costs-of-service pricing and implemented producer parity pricing. The court merely reviewed the facts as presented and declared the rights of the parties under the contracts in question. The determinative fact, which was not disputed, was that Respondent had paid and was paying to Petitioners more in royalties than it collected for the gas produced. The court did not hold that the prices Respondent had charged for the gas were too high or too low, proper or improper. It

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[4] All citations are to Petitioners' Appendix.

[5] An additional clause, the "500 Mcf Clause," is not a part of Petitioners' application.

merely stated, as an undisputed fact, what prices Respondent had collected for the gas.[6]

Petitioners contended in the Texas Court of Appeals that Respondent had a duty, under Texas law, to sell the gas produced from the leases at a price sufficient to prevent the wells from becoming unprofitable. App. at 18a, 19a. That contention was squarely rejected. *Id.* The court agreed with Petitioners that Respondent could seek, and the FERC could authorize, a higher price than that fixed by the Natural Gas Policy Act. App. at 18a. Because Respondent had no duty to seek a higher price for the gas, the question of what price Respondent could have obtained was academic.

2. The Supreme Court does not have jurisdiction to review the decision of the Texas Court of Appeals.

As is readily apparent from the Texas Court of Appeals decision, the court's holding turned exclusively on a question of state law, namely, the duty owed by Respondent to market the gas produced in such a way as to keep the properties profitable. The court found, as a matter of state oil and gas law, that Respondent had no such duty since Petitioners' royalty income did not depend on the price at which the gas was sold.

This Court will not review a state court decision that was decided exclusively on state law grounds. 28 U.S.C. § 1257

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[6] Petitioner's assertions that El Paso is somehow precluded from repricing its pipeline production previously included in its rates on a cost-of-service basis are in error. El Paso was specifically granted such authority by the FERC for all periods after June 1, 1982. *See El Paso Natural Gas Co.*, 20 F.E.R.C. (CCH) ¶ 61,443 at p. 61,913 (1982). It deferred such repricing until after this Court's decision in *Mid-Louisiana* by agreement in settlement of its rate case in Docket RP 82-83. See note 3, *supra*. Further, Petitioners reference to *Kentucky-West Virginia Gas Co.* 21 F.E.R.C. (CCH) ¶ 61,257 (1982) is misplaced. In that case, relying on its previous decision in *El Paso Natural Gas Co., supra*, the FERC allowed *Kentucky-West Virginia Gas Co.* to reprice its pipeline production prospectively after the expiration of its rate case settlement agreements. 21 F.E.R.C. (CCH) at p. 61,555.

(1982); *Exxon Corp.* v. *Eagerton*, 462 U.S. 176 (1983). Nor will the Court review a state court judgement that rests on adequate and independent state grounds merely for the purpose of rendering an advisory opinion on a question of federal law. *Herb* v. *Pitcairn*, 324 U.S. 117, 125-126 (1945). Yet Petitioners ask this Court to review the judgment of the Texas court on an issue that it did not reach and which would not affect the Texas court's judgment.

The petition should be declined because this Court lacks jurisdiction to review the case under 28 U.S.C. § 1257 (1982).

3. The sole Question Presented in the petition is one of fact, which the Texas Court of Appeals found unnecessary to decide.

The essence of Petitioners' Question Presented is that the Texas court erred in finding that the maximum lawful price that Respondent could charge for the gas produced was based on producer-parity pricing. Petition at 10, 11. However, the Texas Court of Appeals found it unnecessary to decide this question since the court found, as a matter of law, that Respondent had no duty to market the gas at the highest lawful price. App. at 15a-19a. The factual question of whether Respondent might have been able to obtain a higher price for the gas from the FERC was, therefore, academic.[7] The question was, moreover, assumed in Petitioners' favor. App. at 15a.

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[7] Petitioners are in error when they state that Respondent's "NGPA rate on the GLA gas was its cost-of-service rate which included royalty payments to Petitioners." Petition at 10. Further, they misstate the recent holdings of the FERC in Order 391-B, "First Sales of Pipeline Production Under Section 2(21) of the Natural Gas Policy Act of 1978," 40 F.E.R.C. (CCH) ¶ 61,174 (1987), reh'g granted, 52 Fed. Reg. 37,928 (Oct. 13, 1987). In Order 391-B, the FERC held that a cost-of-service rate is *not* the appropriate rate under § 104 (b)(1) because ". . . the Commission never established a just and reasonable rate for pipeline produced old gas." *Id.* at 61,545. The Commission noted that in the rare instance where continuation of cost-of-service treatment

The Texas Court of Appeals found that, while Respondent could have sought and the FERC could have authorized a higher price, Respondent had no duty to seek such a price. App. at 15a. The question of Respondent's implied duty to Petitioners, or the lack of any such duty, is simply not a federal question. Any judgment this Court could render on any federal question related to this case would be an advisory opinion on a question that was conceded by the Texas court.

4. This Court will not review a state court judgment on an academic or episodic question of law.

The questions of law involved in this litigation are necessarily of limited public importance, arising from a highly unusual, if not unique, set of facts. Respondent has conveyed fully developed and producing gas wells worth millions of dollars to Petitioners, free of all costs of development and production, solely because the royalties Respondent must pay petitioners exceed the revenues produced by the wells. The sole question presented in the Texas court was whether Respondent had a right to do so under the terms of the GLAs and whether the exercise of this right violated any implied duty owed to Petitioners by Respondent under Texas law. Such a question had never before been litigated for the simple reason that gas lease operators infrequently find it necessary or desirable to engage in litigation in order to give away millions of dollars worth of property. The question is unlikely ever to arise again and is of significance only to the immediate parties. This Court will not review questions of importance only to the parties involved in the litigation. *Layne and Bowler Corp.* v. *Western Well Works,* 261 U.S. 387, 393 (1923); *Rice* v. *Sioux City Cemetery,* 349 U.S. 70, 79 (1955). For these reasons, the petition should be denied.

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would result in a higher rate than the otherwise applicable NGPA ceiling price it would undertake case-specific review for continued availability of cost-of-service pricing. *Id.* at 61,546 n.11.

V.
CONCLUSION

For all the reasons stated, and in particular because this Court lacks jurisdiction, the petition should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Robert J. King, a member of the Bar of this Court, hereby certify that on this 13th day of January, 1988, a copy of the Reply to Petition for a Writ of Certiorari in the above-entitled case was mailed, first class postage prepaid, to Charles M. Darling, IV, Steven R. Hunsicker, John P. Babb, Baker & Botts, 1701 Pennsylvania Avenue, N.W., Washington, D.C. 20006, counsel for Petitioners, Fina Oil and Chemical Company, *et. al.* I further certify that all parties required to be served, have been served.

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